

**Testimony on
S.B. 381, S.B. 383, S.B. 384, S.B. 385, and H.B. 5403**

Finance, Revenue, and Bonding Committee
March 15, 2021

Dear Senator Fonfara, Representative Scanlon, Senator Martin, Representative Cheeseman, and members of the Finance, Revenue and Bonding Committee:

Connecticut Voices for Children (CT Voices) takes the following position on several of the proposed bills:

To reduce the unfair tax burden on working- and middle-class families, CT Voices **supports S.B. 383, “An Act Increasing the Applicable Percentage of the Earned Income Tax Credit,” and H.B. 5403, “An Act Establishing A Child Tax Credit Against the Personal Income Tax.”**

To reduce wealth inequality and the racial wealth gap, CT Voices **supports S.B. 384, “An Act Implementing the Treasurer’s Recommendation’s Concerning the Connecticut Baby Bond Trust Program.”**

To increase tax revenue and tax transparency, both of which are essential to reduce the unfair tax burden on working- and middle-class families, CT Voices **supports a modified version of S.B. 381, “An Act Concerning A Study of State Revenue Collections.”**

Below, we review in detail the reason for our position on each bill.

Reducing the Unfair Tax Burden Working- and Middle-Class Families

CT Voices supports S.B. 383, “An Act Increasing the Applicable Percentage of the Earned Income Tax Credit,” and H.B. 5403, “An Act Establishing A Child Tax Credit Against the Personal Income Tax.”

S.B. 383 would increase the Connecticut earned income tax credit (CT EITC) from 30.5 percent of the federal EITC to 41.5 percent, and H.B. 5403 would establish a Connecticut child tax credit (CT CTC) of up to \$600 per child. CT Voices support these bills for the following reasons:

Increasing the CT EITC would make Connecticut’s tax system fairer and help working-class families make ends meet. As **Table 1** shows, families making less than about \$45,000 pay nearly 26 percent of their income in state and local taxes, whereas the wealthiest families pay less than 7 percent. This unfair tax system exacerbates income inequality and the racial income gap, which makes it harder for working-class families, which disproportionately includes families of color, to make ends meet. For example, this January, more than half of Connecticut’s families had difficulty paying usual expenses (e.g., food, housing, utilities), and the percentage of families struggling was even higher for certain subgroups, especially working-class and lower-middle-class families (78 percent and 62 percent), Black and Hispanic families (77 percent and 74 percent), and families with children (65 percent).¹

If S.B. 383 becomes law, a two-child, married family making \$22,500—the average working-class income—would receive about an additional \$660, for a total CT EITC of about \$2,500. The family would then likely quickly use that additional support on food, housing, utilities, and other necessities, and that increased spending would in turn boost Connecticut’s relatively slow growing economy.²

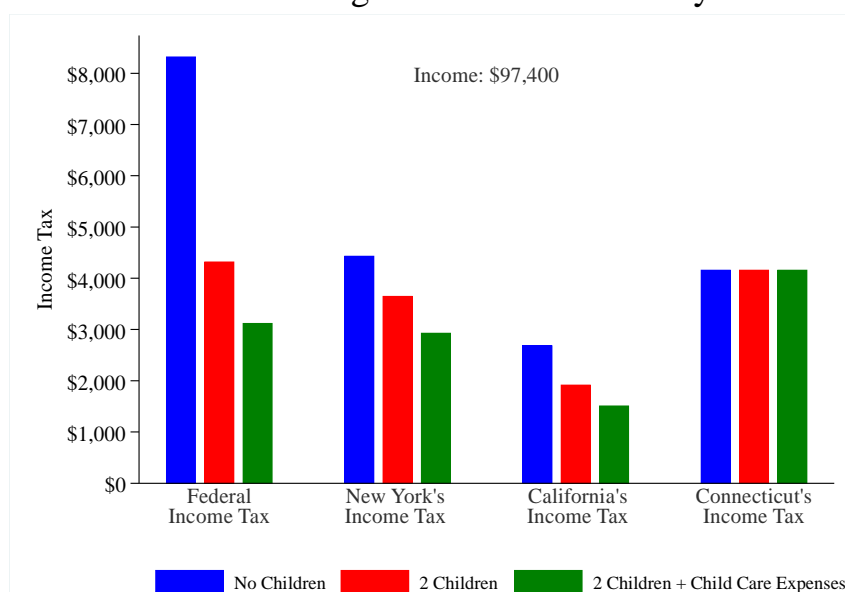
Table 1. Total State and Local Effective Tax Rate by Income Decile

Income Decile	Adjusted Gross Income	Tax Filers	Effective Tax Rate			
			2011	2019	Change	
					Included Taxes	Same Taxes**
1	\$0 to \$44,758	850,332	23.62%	25.96%	+2.34 pp	+3.73 pp
2	\$44,758 to \$74,688	308,221	13.93%	19.55%	+5.62 pp	+6.15 pp
3	\$74,688 to \$107,823	199,666	13.35%	15.50%	+2.15 pp	+2.64 pp
4	\$107,823 to \$148,081	142,306	12.87%	15.73%	+2.86 pp	+3.32 pp
5	\$148,081 to \$205,199	103,736	11.93%	12.23%	+0.30 pp	+0.77 pp
6	\$205,200 to \$316,507	71,895	10.53%	11.47%	+0.94 pp	+1.40 pp
7	\$316,513 to \$602,253	42,689	9.03%	10.35%	+1.32 pp	+1.70 pp
8	\$602,263 to \$1,631,362	19,672	7.69%	8.99%	+1.30 pp	+1.61 pp
9	\$1,631,481 to \$8,246,680	5,746	6.50%	7.08%	+0.58 pp	+1.33 pp
10	\$8,249,490 to \$387,821,183	772	6.28%	6.64%	+0.36 pp	+0.84 pp

*Data from CT DRS and author’s calculations. **The DRS’ calculation of the 2019 effective tax rate excludes four taxes that still exist and that are included in the calculation of the 2011 effective tax rate. The “same taxes” column is the change in the effective tax rate from 2011 to 2019 when comparing the taxes included in both tax studies.

Establishing the CT CTC would make Connecticut’s tax system fairer and help both working-class and middle-class families make ends meet. Although working-class families (i.e., income decile 1) pay the highest percentage of their income in state and local taxes, middle-class families (i.e., income deciles 2 through 5) also pay a substantially higher percentage of their income in state and local taxes than the wealthy. For example, a family in Connecticut making \$97,400—the average middle-class income—pays on average 15.5 percent of their income in taxes, which is more than twice the effective tax rate for a family making millions of dollars a year. Moreover, because Connecticut’s tax system does not adjust for family size and/or child care expenses—unlike nearly every other state with an income tax—it especially burdens families with children and child care expenses. For an overview of the problem, **Figure 1** shows what Connecticut’s average middle-class family pays in the federal income tax and the state income tax, and it also shows what the family would pay if it moved to two other high cost of living states: New York and California, the first and fourth most popular destinations, respectively, for families that leave Connecticut. The key finding is that the federal income tax, New York’s income tax, and California’s income tax all adjust for family size and child care expenses, meaning a family’s income tax decreases if it has children and, even more so, if it has child care expenses. This is because the high cost of raising children lowers a family’s “ability to pay,” which is the foundational principle of the income tax. Connecticut’s income tax, however, violates this principle. As a result, Connecticut’s average middle-class family with two children pays nearly as much in the state income tax as the federal income tax; it pays more in the state income tax than the federal income tax if it has child care expenses; and it would pay considerably less in the state income tax if it moved to New York or California. Put in more general terms, in failing to adjust for family size or child care expenses, Connecticut’s tax system makes it more difficult for families to have children and incentives families that already have children to leave the state.³

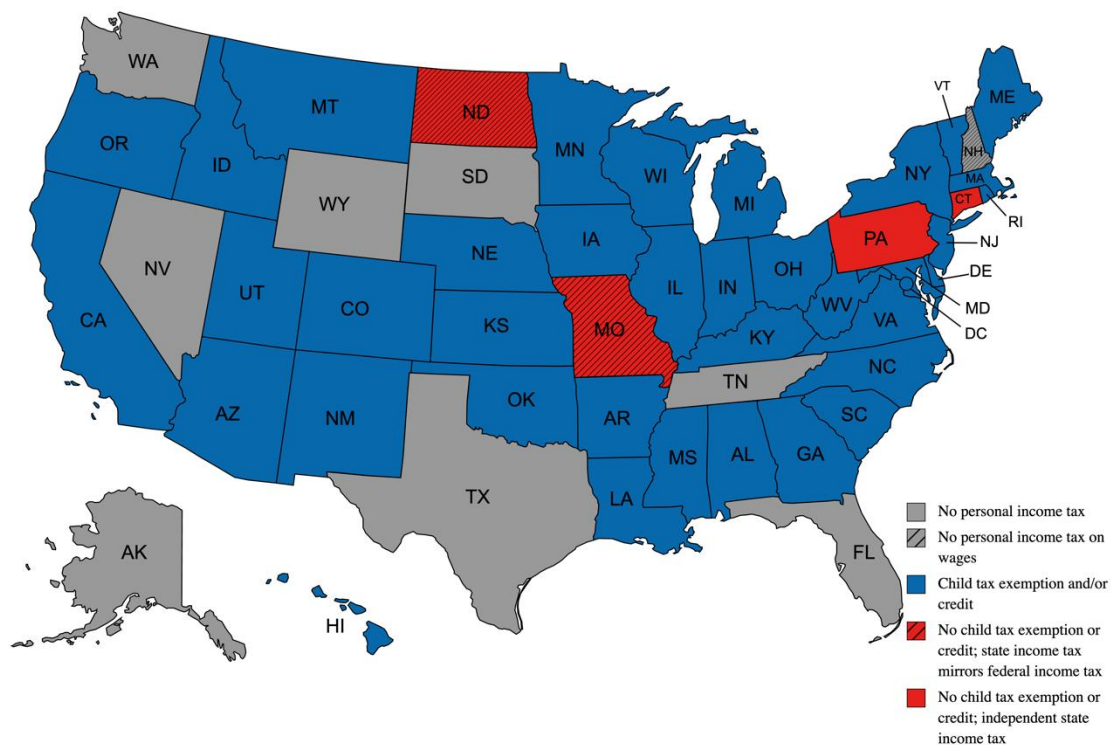
Figure 1. Federal and State Income Tax for the Average Middle-Class Family



*Data from relevant federal and state authorities and author’s calculations.

Connecticut is the only high cost of living state with an income tax that does not adjust for family size or child care expenses to help offset the high and growing cost of raising children. As reviewed above, the federal income tax and other state income taxes adjust for family size and/or child care expenses to help offset the high and growing cost of raising children. For a comprehensive overview of other states, **Figure 2** shows that of the 41 states that have a personal income tax on wage income, 38 states have (1) an exemption for children that indirectly reduces a family's tax liability and/or (2) a tax credit for children—in the form of a child tax credit (CTC), a child and dependent care tax credit (CDCTC) or both—that directly reduces a family's tax liability. Of the four remaining states, two—Missouri and North Dakota—do not have an exemption for children because their income tax mirrors in part the federal income tax, which temporarily removed the personal exemption that a family could claim for children and expanded the CTC in its place. This leaves only two states—Connecticut and Pennsylvania—that have an independent state income tax on wage income that does not help to offset the high and growing cost of raising children. Moreover, of the four states with income taxes that do not adjust for family size or child care expenses, three states—Missouri, North Dakota, and Pennsylvania—are relatively low cost of living states based on the leading data from the U.S. Bureau of Economic Analysis. Connecticut is therefore the only high cost of living state with an income tax that does not adjust for family size or child care expenses to help offset the high and growing cost of raising children.⁴

Figure 2. State Income Tax Support for the High and Growing Cost of Raising Children



*Data from the Tax Foundation, Tax Credits for Workers and Families, and each state's relevant tax authority.

If H.B. 383 becomes law, a two-child, married family making \$22,500 (the average working-class income) would receive \$840 (\$420 per child) from the CT CTC in addition to the approximately \$2,500 it would receive from the increased CT EITC. A two-child, married family making \$97,400 (the average middle-class income) would receive \$1,200 (\$600 per child) from the CT CTC. As **Figure 3** and **Figure 4** show, the CT EITC primarily supports working-class families and the CT CTC supports both working-class and middle-class families. Expanding the CT EITC and establishing the CT CTC are therefore both essential to make Connecticut's tax system fairer. Specifically, working-class families have the highest overall effective tax rate and would receive the CT EITC and CT CTC, and middle-class families have the second highest effective tax rate and would generally receive only the CT CTC.⁵

The proposed CT CTC would provide support for over 600,000 children, including up to about 95,000 children living in poverty, which disproportionately includes children of color. The Institute on Taxation and Economic Policy (ITEP), a nonpartisan think tank, estimates that over 600,000 children would benefit from the proposed CT CTC. Additionally, the U.S. Census Bureau estimates that 101,000 children (14 percent) live in poverty in Connecticut, including 24,000 Black children (27 percent) and 53,000 Hispanic children (29 percent). Of the children living in poverty, an estimated 96,000 are under age 17 and would potentially qualify for support from the CT CTC.⁶

Increasing the CT EITC and establishing the CT CTC would strengthen the effectiveness of CT Baby Bonds in reducing wealth inequality and the racial wealth gap. CT Baby Bonds—discussed below—are funded by borrowing, which in turn is funded by the state's unfair tax system. This means families that benefit from CT Baby Bonds are also likely disproportionately contributing to its funding, which decreases the program's effectiveness. Therefore, by making Connecticut's tax system fairer through the CT EITC and CT CTC, policymakers would also strengthen the effectiveness of CT Baby Bonds.

Figure 3.

Connecticut Earned Income Tax Credit, 2021

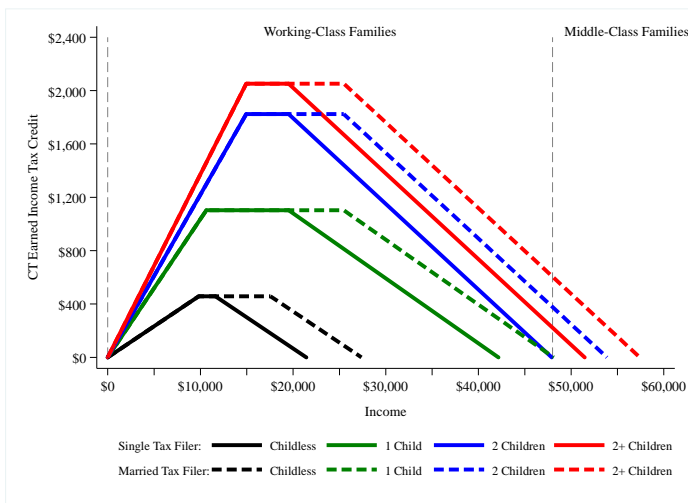
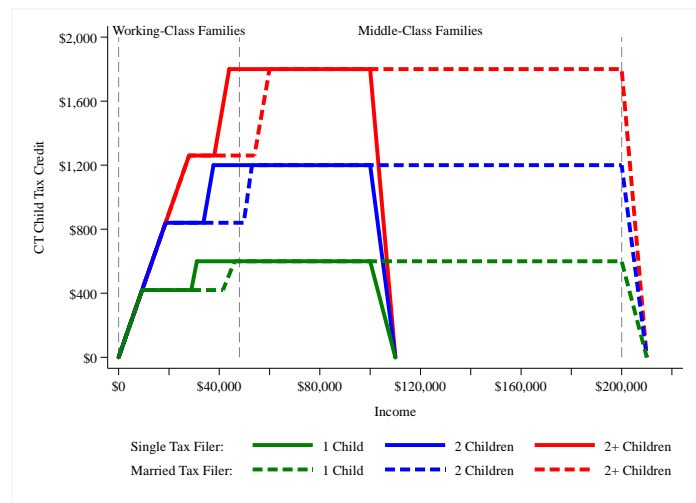


Figure 4.

Proposed Connecticut Child Tax Credit



*Data from CT DRS, Internal Revenue Service, CT General Assembly, and author's calculations.

Reducing Wealth Inequality and the Racial Wealth Gap

CT Voices supports S.B. 384, “An Act Implementing the Treasurer’s Recommendation’s Concerning the Connecticut Baby Bond Trust Program.”

S.B. 384 would implement the Treasurer’s recommendations concerning the Connecticut Baby Bond Trust program. CT Voices support the bill for the following reasons:

The wealth share for the top one percent of the population in the U.S. exceeds the wealth share for the combined working and middle class (i.e., the bottom 90 percent). And wealth inequality is likely even greater in Connecticut than in the U.S. as a whole. According to the Federal Reserve, the wealth share for the top one percent of the population in the U.S. in 2021 was 32.1 percent, which is greater than the share of 30.4 percent for the entire bottom 90 percent of the population. Moreover, due in large part to Connecticut’s substantial income inequality, which contributes to wealth inequality, our research shows that wealth inequality is likely even greater in Connecticut than in the U.S. as a whole.⁷

The decades-long rise in wealth inequality in the U.S. includes a substantial racial wealth gap. And the racial wealth gap is likely even greater in Connecticut than in the U.S. as a whole. According to data from the U.S. Census Bureau and the Federal Reserve, 76.3 percent of the U.S. population is white and the share of wealth for white families is 83.7 percent. In comparison, 13.4 percent of the population is Black and the share of wealth for Black families is only 4.3 percent, meaning the rise in wealth inequality in the U.S. includes a substantial racial wealth gap. Moreover, due in large part to Connecticut’s substantial racial income gap, which contributes to the racial wealth gap, our research shows that the racial wealth gap is likely even greater in Connecticut than in the U.S. as a whole.⁸

S.B. 384 would strengthen the Connecticut Baby Bond Trust Program, which would help to reduce wealth inequality and the racial wealth gap in Connecticut. The Connecticut Baby Bond Trust Program is designed to reduce wealth inequality and the racial wealth gap by investing up to \$3,200 for every child whose birth is covered by HUSKY (Connecticut’s public health insurance program for low income families). When the beneficiary turns 18 they can then request the funds, which will likely exceed \$10,000 and can be used to buy a home, pay for higher education, invest in a business, or save for retirement. S.B. 384 would strengthen the Connecticut Baby Bond Trust program in several ways. Most notably, it would adjust the timeline of the funding so that it is prospective rather than retrospective and it would ensure that unused funds remain in the program, all of which would make the program more self-sustaining and increase the likelihood that it continues even if Connecticut’s fiscal situation deteriorates and future funding fall shorts.

Increasing Tax Revenue and Tax Transparency

CT Voices supports a modified version of S.B. 381, “An Act Concerning A Study of State Revenue Collections.”

This bill would instruct the commissioner of Department of Revenue Services to “study the [DRS’] collection processes to identify legislative and programmatic changes that may be made to improve efficiency and reduce administrative costs of such collection processes.” For the following reasons, CT Voices supports a modified version of the bill:

Unlike other departments, the DRS generates money for the state and therefore CT Voices recommends that legislators change the focus of the study from “improv[ing] efficiency and reduc[ing] administrative costs” to “reducing Connecticut’s tax gap and maximizing revenue collection.” The FY 22 budget estimates a revenue gain of \$40 million due to the implementation of a tax amnesty program. This follows tax amnesty programs in 1990, 1995, 2002, 2009, and 2013, one of which alone raised nearly \$200 million, and it is evidence that Connecticut has a tax gap—the difference between the tax owed to the government and the tax actually collected. Also notable, the FY 23 budget estimates an annual revenue gain of \$40 million due to a spending increase of \$1.13 million “for a Data Analytics Initiative within DRS comprising software costs of \$750,000 ... and Personal Services costs for five positions (one Program Manager and four Economists).” This is a \$35 return in revenue for each \$1 spent, which shows that, unlike other departments, the DRS generates money for the state. It is also further evidence of a substantial tax gap.⁹

Connecticut’s income tax gap is likely substantial—a starting estimate \$2.6 billion or 19.4 percent. At the federal level, the Internal Revenue Service (IRS) highlights two key causes of the income tax gap: “opaque income sources that accrue disproportionately to higher earners” (e.g., business income and rental income) and the IRS’s limited, decreasing resources to ensure tax compliance. As we show in a recent report, the problem of a tax gap that primarily benefits the wealthy due to limited information reporting appears to be even greater in Connecticut than in the U.S. as a whole because Connecticut has a higher share of “opaque income sources that accrue disproportionately to higher earners.” Moreover, like the IRS, the DRS’ staff has decreased by 25 percent over the last two decades, which has diminished Connecticut’s tax compliance capacity. This is especially important considering the state’s above average reliance on “opaque income sources that accrue disproportionately to higher earners.” Applying the percentage of the federal income tax gap to Connecticut—a reasonable starting point based on the preceding analysis and lack of an official estimate from the state—CT Voices estimates that the income tax gap in Connecticut is \$2.6 billion (or 19.4 percent). Closing or reducing this gap through increased funding for the DRS would generate more than enough revenue to fund several major proposed tax reforms, such as creating the Connecticut child tax credit (CT CTC), expanding the Connecticut earned income tax credit (CT EITC), and expanding the Connecticut property tax credit (CT PTC).¹⁰

CT Voices opposes S.B. 385, “An Act Concerning the Amount of the Digital Media Tax Credit.”

This bill would increase the amount of the digital media tax credit to be claimed against the sales tax. CT Voices opposes it for the following reasons:

Based on its own analyses, the Connecticut Department of Economic and Community Development (DECD) finds that the film and digital media production tax credit has cost the state hundreds of millions of dollars over the last decade. The DECD’s 2019 annual report—the most recent annual report to address the issue—estimates that the net revenue loss to the state from 2010 through 2019 due to the film and digital media production tax credit totaled \$585 million, for an annual average loss of \$58 million. CT Voices believe that a better use of this money is to invest it in Connecticut’s working- and middle-class families by increasing the CT EITC and establishing the CT CTC.¹¹

The recent consultant-written report that the DECD released provides insufficient support for expanding the digital media tax credit or any of the related film tax credits. This year, the DECD published a consultant-written report that provides a far more positive assessment of Connecticut’s “screen production” tax credits. We have serious questions concerning the differences between the DECD’s own earlier analyses and this new consultant-written report. For example, a substantial portion of the new report is based on an estimate of “additionality”—that is, how much “the availability of Connecticut’s Screen incentives attract production expenditure into the state that would not otherwise have occurred.” To develop an estimate, the report explains that “a limited survey of significant producers was undertaken. Producers were asked the extent to which the incentives were a determining factor in their decision to produce in Connecticut. ... The mean response was that 27% of production would have happened without the incentive” and so “an additionality rate of 73% was used” in the analysis throughout the report. We are concerned about the findings of an analysis that relies in large part on a survey of producers that may have ongoing or potential future financial incentive to continue to the tax credit. Also notable, the new report itself essentially acknowledges that the findings should be taken with caution due to data limitations. As the report puts it, “Given the complexities of modeling the economic impact of the film and television sector in Connecticut, future analyses would be more accurate if more targeted data collection could be implemented by the Client” (i.e., the Connecticut government).¹²

The Connecticut Auditors of Public Accounts (APA) has identified serious problems with the DECD’s operations and management of tax credits, including a nearly \$50 million overpayment of the film and digital media production tax credit. In 2021, the APA’s report on the DECD found that the latter had “issued \$49,410,602 more in film production tax credits to a digital animation company than it would have been entitled to under the digital animation tax credit program. DECD should ensure that digital animation companies do not receive more than \$15 million in tax credits in any one fiscal year as required by Section 12-217ll of the General Statutes.”¹³

Thank you for your consideration,

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